

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

State =

Dear \_\_\_\_\_ :

This responds to a letter signed August 22, 2014, and subsequent correspondence, submitted on behalf of X by X's authorized representative, requesting relief under § 1362(f) of the Code.

#### FACTS

According to the information submitted and representations within, X was incorporated and elected to be taxed as an S corporation effective Date 1, under the laws of State.

A, a shareholder of X, transferred X stock to Trust 1. Trust 1 was an eligible shareholder under §1361(c)(2)(A)(i). A died on Date 2. Trust 1 remained an eligible shareholder of X under § 1361(c)(2)(A)(ii) until Date 3.

As of Date 3, it was intended for the X stock to be transferred to Trust 3 for the benefit of B. Trust 3 was eligible to elect to be treated as a qualified subchapter S trust (QSST).

Nonetheless, on Date 3, the X stock was not transferred to Trust 3. Instead, it was held in a separate share of Trust 1 for the benefit of B and administered as a QSST. On Date 4, Trust 1 transferred the X stock to Trust 2 where it was also held as a separate share of Trust 2 for the benefit of B and administered as a QSST. On Date 5, Trust 2 transferred the X stock to Trust 3. On Date 6, B died. C is the co-executor of B's estate.

B did not file a QSST election with respect to Trust 1, Trust 2 or Trust 3.

X's S corporation election terminated on Date 3 when Trust 1 became an ineligible shareholder. Had X's S corporation election not already terminated on Date 3, X's S corporation election would have also terminated on Date 4 and Date 5 when the X stock

was again transferred to ineligible shareholders. X represents that the circumstances resulting in the termination of X's S corporation election did not come to anyone's attention until Date 7, when B's estate tax return was being prepared. X represents further that all circumstances resulting in the termination of its S corporation election were unintentional and not motivated by tax avoidance or retroactive tax planning.

X represents that X filed returns consistent with X being treated as an S corporation. X represents that Trust 1, Trust 2, and Trust 3 filed returns consistent with the X stock being held by a QSST. X further represents that B filed her returns consistent with Trust 1, Trust 2, and Trust 3 being treated as a QSST with respect to the X stock held for her benefit by those trusts. X and its shareholders agree to make any adjustments, consistent with X being treated as an S corporation, as may be required by the Secretary.

## LAW AND ANALYSIS

Section 1361(a)(1) of the Code provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1) defines a "small business corporation" as a domestic corporation which is not an ineligible corporation and which does not (A) have more than 100 shareholders, (B) have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than 1 class of stock.

Section 1361(c)(2)(A)(i) provides that for purposes of § 1361(b)(1)(B), a trust all of which is treated (under subpart E of part 1 of subchapter J of Chapter 1) as owned by an individual who is a citizen or resident of the United States may be a shareholder.

Section 1361(c)(2)(A)(ii) and § 1.1361-1(b)(1)(ii) provide that, for purposes of § 1361(b)(1)(B), a trust that is described in § 1361(c)(2)(A)(i) immediately before the death of the deemed owner and that continues in existence after such death is a permitted S corporation shareholder, but only for the two-year period beginning on the day of the deemed owner's death.

Section 1361(d)(1) provides that a QSST whose beneficiary makes an election under § 1361(d)(2), will be treated as a trust described in § 1361(c)(2)(A)(i) and the beneficiary of such trust shall be treated as the owner (for purposes of § 678(a)) of that portion of the trust which consists of stock in an S corporation with respect to which the election under § 1361(d)(2) is made. Under § 1361(d)(2)(A), a beneficiary of a QSST may elect to have § 1361(d) apply. Under § 1361(d)(2)(D), this election will be effective up to 15 days and two months before the date of the election.

Section 1361(d)(3) provides that for purposes of § 1361(d), the term “qualified subchapter S trust” means a trust (A) the terms of which require that – (i) during the life of the current income beneficiary, there shall be only 1 income beneficiary of the trust; (ii) any corpus distributed during the life of the current beneficiary may be distributed only to such beneficiary; (iii) the income interest of the current income beneficiary in the trust shall terminate on the earlier of such beneficiary’s death or the termination of the trust; and (iv) upon the termination of the trust during the life of the current income beneficiary, the trust shall distribute all of its assets to that beneficiary; and (B) all of the income (within the meaning of § 643(b)) of which is distributed (or required to be distributed) currently to 1 individual who is a citizen or resident of the United States. For purposes of § 1361(d), a substantially separate and independent share of a trust within the meaning of § 663(c) shall be treated as a separate trust.

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the 1st day of the 1st taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d)(2) or (3), (2) the Secretary determines that the circumstances resulting in such termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in such termination, steps were taken so that the corporation for which the termination occurred is a small business corporation, and (4) the corporation for which the termination occurred, and each person who was a shareholder in such corporation at any time during the period specified pursuant to 1362(f), agrees to make such adjustments (consistent with the treatment of such corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

## CONCLUSION

Based solely on the facts submitted and the representations made, we conclude that X’s S corporation election terminated on Date 3 when Trust 1 became an ineligible shareholder. Further, had X’s S corporation election not already terminated, X’s S corporation election would have terminated again on Date 4 and on Date 5. We further conclude that all of these terminating events were inadvertent within the meaning of § 1362(f).

Accordingly, under § 1362(f), X will be treated as continuing to be an S corporation from Date 3 and thereafter, provided that X’s S corporation election is valid and not otherwise terminated under § 1362(d).

This relief is contingent upon C, the co-executor of B's estate, filing a QSST election for Trust 3 effective Date 5 within 120 days from the date of this letter. A copy of this letter must be attached to the election.

Except as specifically ruled upon above, we express or imply no opinion concerning the federal tax consequences of the facts of this case under any other provision of the Code.

This ruling is directed only to the taxpayer who requested it. According to § 6110(k)(3), this ruling may not be used or cited as precedent.

Pursuant to the power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

Sincerely,

Faith Colson

Faith Colson  
Senior Counsel, Branch 1  
Office of the Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosures (2)

Copy of this letter

Copy of this letter for section 6110 purposes